Analysis of Operating Results

In fiscal 2011, ended March 31, 2012, consolidated net sales of the MHI Group fell ¥82.8 billion or 2.9% to ¥2,820.9 billion. Net sales performance primarily reflected declines in the Machinery & Steel Infrastructure Systems, which outweighed growth mainly in the General Machinery & Special Vehicles and Aerospace Systems.

Operating income rose ¥10.7 billion, or 10.6% year on year, to ¥111.9 billion. While the yen’s appreciation was a factor undercutting earnings, income rose mainly due to improved profitability in the General Machinery & Special Vehicles and Power Systems.

Net non-operating expenses were ¥25.7 billion, an improvement of ¥7.3 billion from the previous fiscal year, as improvement in equity in foreign exchange loss offset a worsening equity in losses of unconsolidated subsidiaries and affiliates.

As a result, ordinary income climbed ¥18.0 billion, or 26.5% year on year, to ¥86.1 billion.

The MHI Group posted an extraordinary gain of ¥28.3 billion from sales of fixed assets including the head office building. The Group also posted an extraordinary loss of ¥44.6 billion. This extraordinary loss included business structure improvement expenses, such as the disposal of on-shore wind turbine inventory.

Consequently, income before income taxes and minority interests increased ¥30.3 billion, or 76.8% year on year, to ¥69.8 billion. Net income, meanwhile, decreased ¥5.5 billion, or 18.5%, from the previous fiscal year to ¥24.5 billion, primarily as a result of corporate tax rate revisions.

Key Factors Affecting Operating Results

Key factors that affect the management of the MHI Group include external factors such as market trends, foreign exchange rate fluctuations and changes in material costs, and internal factors such as risks associated with various overseas business contracts, accidents and disasters, and weakening manufacturing capabilities.

Market trends

Market trends are expected to hold to an improvement trajectory overall, supported by robust performance in emerging economies. For the MHI Group, there is recognition that the operating environment will grow more severe going forward, with competition heating up as prominent companies from around the world vie for a stake in fast-growing emerging markets. In this climate, the MHI Group will win out against this stiffer competition to achieve future growth and development by building a management structure capable of responding rapidly to the market’s dramatic changes and delivering consistent earnings. At the same time, the Group will endeavor to leverage unrivaled technology to provide products and services that answer customer needs.
Exchange rate fluctuation
The MHI Group’s export and overseas business transactions are mainly denominated in foreign currencies. Consequently, foreign exchange rate fluctuations can significantly affect business competitiveness and operating results. In order to minimize exchange rate fluctuation risk, the Group is increasing its liabilities denominated in foreign currencies by expanding overseas procurement and production, and hedging risk by promoting greater use of yen-denominated contracts, coupled with timely forward foreign exchange contracts.

Change in costs of materials
The MHI Group is responding to the impact of certain material price rises, such as for steel products, nonferrous metals and crude oil, promoting design standardization, increasing its utilization of common components, promoting employment of standardized parts, and expanding its signing of comprehensive procurement contracts and its overseas production activities. The Group is also strengthening relationships with its business partners, promoting an even greater level of information sharing, and striving to achieve further cost reductions.

Overseas business contracts
The MHI Group is exposed to a number of risks associated with individual business contracts it concludes in overseas markets. These include quality issues and delayed delivery dates for locally procured materials, inadequate skill levels and specific labor practices of the local staff, as well as unilateral contractual obligations. In order to prevent or mitigate these risks, all contracts undergo a rigorous internal assessment process prior to their formal conclusion. In addition to the segments concerned, several administrative departments are involved in this process, which includes the verification of local obligations with respect to procurement and labor contracts, extensive advance verification of contract terms with customers, the removal of unilateral conditions, and other prudent steps.

Accidents and disasters
Regarding accidents and disasters, the MHI Group is taking steps to minimize the probability of accidents and disasters occurring, which can have a significant impact on management, by carrying out ongoing work-site management activities, including the training of on-site workers to be more aware of risks.

Technology and skill transfer
The MHI Group is at risk of manufacturing capabilities weakening due to technology and skill transfer issues, particularly those associated with generational change. In response, the MHI Group invests in production process improvement aimed at rationalization and carries out focused investment in R&D related to manufacturing technology. The Group also strives to maintain and enhance its basic manufacturing capabilities through programs to train and improve the skills of its employees.
Source of Funds and Liquidity

Cash flow analysis
Operating activities provided net cash of ¥200.3 billion for the fiscal year under review, a decrease of ¥137.4 billion compared with the previous fiscal year. This outcome mainly reflected increases in trade receivables.

Investing activities used net cash of ¥47.0 billion, ¥90.2 billion less than the previous fiscal year. This decrease was mainly due to an increase in proceeds from sales of property, plant, equipment and intangible assets.

Financing activities used net cash of ¥183.6 billion, ¥13.8 billion more than the previous fiscal year. This rise was due mainly to an increase in repayment of long-term borrowings.

Primary funding requirements
The MHI Group primarily requires funds in operating activities for working capital for manufacturing activities (materials, outsourcing and personnel costs), order preparation costs and other sales expenses related to winning new orders, and funds for R&D activities that enhance the competitiveness of its products and strengthen manufacturing capabilities. In investing activities, funds are required for capital investments to grow business and enhance productivity, and for the purchase of investment securities related to the execution of business strategies.

In growth areas, the MHI Group is planning to execute necessary capital investments and R&D investment. As a whole, the Group plans to streamline its assets and selectively concentrate on core investment schemes, while anticipating fund requirements in future growth fields and closely monitoring the latest market environments and order trends. Accordingly, funding requirements are expected to trend lower going forward.

Breakdown of interest-bearing debt and its applications
The breakdown of interest-bearing debt as of March 31, 2012 was as follows:

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Due within one year</th>
<th>Due after one year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term borrowings</td>
<td>¥ 152.3</td>
<td>¥152.3</td>
<td>¥ —</td>
</tr>
<tr>
<td>Long-term borrowings</td>
<td>684.9</td>
<td>131.7</td>
<td>553.1</td>
</tr>
<tr>
<td>Bonds</td>
<td>319.9</td>
<td>69.9</td>
<td>250.0</td>
</tr>
<tr>
<td>Total</td>
<td>1,157.1</td>
<td>353.9</td>
<td>803.1</td>
</tr>
</tbody>
</table>
The MHI Group is involved in numerous projects with comparatively long construction periods. It also owns numerous manufacturing facilities that employ large-scale machinery facilities. Consequently, the MHI Group must secure a stable level of working capital and funds for capital investments. Since the start of the global financial crisis in 2008, the Group has worked to streamline its assets, and has repaid long-term borrowings that have come due. As a result, the total interest-bearing debt of the MHI Group at the end of fiscal year 2011 was ¥1,157.1 billion, consisting of ¥353.9 billion due within one year, and ¥803.1 billion due after one year.

The interest-bearing debt mentioned above is utilized as working capital and for capital investments required for business activities, and the MHI Group plans to use these funds mainly in key growth fields expected to require funds, including Power Systems and Aerospace Systems.

Financial policy
The MHI Group funds its working capital and capital investments from its operating cash flows. Any additional requirements can be met with interest-bearing debt.

In appropriately determining the amounts and methods of procuring long-term funds through long-term borrowings, bonds, and other means, the MHI Group takes into account the funding requirements of its business plans, interest-rate trends and various other factors, as well as the repayment schedule for its existing debt.

Additionally, in its efforts to reduce interest-bearing debt, the MHI Group strives to efficiently utilize surplus funds within the Group using a cash management system. At the same time, the MHI Group is working to improve asset efficiency by reducing trade receivables and inventories and by raising the utilization rate of its property, plant and equipment.

The MHI Group flexibly considers the repurchase of treasury stock based on the financial position of the Group, the stock price, as well as recent earnings forecasts and other factors.